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COMPETITIVENESS AND IT'S INFLUENCE IN THE TRADE BALANCE
A STUDY FOR THE WESTERN BALKAN

Adela Llatja, MsC
University of Tirana, Faculty of Economy, Tirana, Albania

Abstract

European Membership is an important milestone for the countries of the Western Balkan. In order to become ready for the Internal Market the economies of the Western Balkan need to become competitive.

Improving the trade balance has always been a challenge for the countries of the Western Balkan, but the right tools to influence it, are missing. Becoming more competitive will help the countries of the Western Balkan region improve their trade balance and also adopt better the obligations for EU membership.

With a correlation analyses we will show that the trade balance can be improved by improving the goods markets efficiency, by making the business more sophisticated, and by improving the investment climate.

Keywords: Competitiveness**,** trade balance, Western Balkan

Introduction

With the Thessaloniki Agenda (2003), the countries of the Western Balkan (Albania, Bosnia and Herzegovina, Croatia, Macedonia, Serbia and Montenegro) were not only geographically closer together but also politically. They committed to share the values of democracy, the rule of law, respect for human and minority rights, solidarity and a market economy, by respecting international law and regulation, but most importantly for the region, by strengthening regional cooperation. A commitment by all parties for integration was agreed.

Following the road towards European Integration the countries of the Western Balkan signed in December 2006 the CEFTA agreement. This Agreement substituted all the bilateral agreements previously applied in the region. The agreement entered into force in 2007. Member of the CEFTA were: Albania, Macedonia, Moldova, Montenegro, Kosovo, Croatia, Serbia, Bosnia and Herzegovina.

Due to historical similarities and due to the common future the countries of the Western Balkan have to find common tools to make their economies ready for the Internal Market. In this paper we will see how competitive are the countries of the Western Balkan, and we will try to connect the trade balance to competitiveness, in order to identify mechanisms for influencing the trade balance.

I.
Understanding competitiveness

Competitiveness is defined by the productivity with which a country uses it factors, labour, capital, and natural resources. In order to understand the competitiveness of one country, it is important to identify the recourses of wealth (IESE Business School). Almost everything is important for the competitiveness starting from the schooling system, to infrastructure, quality of institutions and up to the sophistication of consumers.

Filó (2007) defines competitiveness as a tendency and capability to compete for more market and more profit, so that the business is successful.

In order for firms to be successful, it is important for them to identify the source of competitiveness. Achieving competitiveness requires strengthening competences, managerial engagement, leadership, innovation, good governance and sustainable use of recourses (Porter, 1990). Porters see competitiveness as a combination of four very important elements; factors; demand; competition structure and firms strategy; and related and supportive industries. Applying Porters model for measuring the competitiveness of regions or countries has difficulties in application, due to lack of data and lack of resource (Rugman, 1991). On the other side the connection between national competitiveness versus firms competitiveness is often criticized (Krugman, 1996).

Since 2005, the World Economic Forum has developed the Global Competitiveness Index (GCI), a tool that measures the competitiveness of nations on a microeconomics and macroeconomics level. The World Economic Forum (2014) defines competitiveness as the set of institutions, policies, and factors that determine the level of productivity of a country. The level of productivity, in turn, sets the level of prosperity that can be reached by an economy. The productivity level also determines the rates of return obtained by investments in an economy, which in turn are the fundamental drivers of its growth rates.

Competitiveness is a complex concept composed of 12 pillars: (1)Institutions, (2)Infrastructure, (3)Macroeconomic environment, (4)Health and primary education, (5)Higher education and training, (6)Goods market efficiency, (7)Labour market efficiency, (8)Financial market development,

(9)Technological readiness, (10)Market size, (11)Business sophistication, and (12)Innovation.

As we can see the twelve pillars are covering a broad area of factors influencing business performance. None of the factors or a pillar can stand alone, as the pillars are interlinked between them. It is difficult to be innovative in an unhealthy society; a well training workforce can handle technology advancements.

Competitiveness and trade balance in the Western Balkan

Based on the last four reports issued by the World Economic Forum on the competitiveness we will compare the countries of the region, to understand which is performing better. As we can see in Figure 1, the Global Competitiveness Index for the countries of the Western Balkan in the last four year varies in the range of 3.6 to 4.4 score out of 7. Where 7 is the maximum and 0 the minimum score a country can get, meaning that the higher is the score, the better is the country performing. The best performing country in the world in 2014-2015 report, is Switzerland with 5.7 Score, and Guinea is the worst with a score 2.79. When examining the competitiveness of the countries of the region from 2011 to today, Montenegro has the best position, being ranked the 60th economy in the world in the 2011-2012 report, and the worst position held is with Serbia, being ranked 101st in the 2013-2014 report. That makes the countries of the Western Balkan to have a moderated competitiveness.

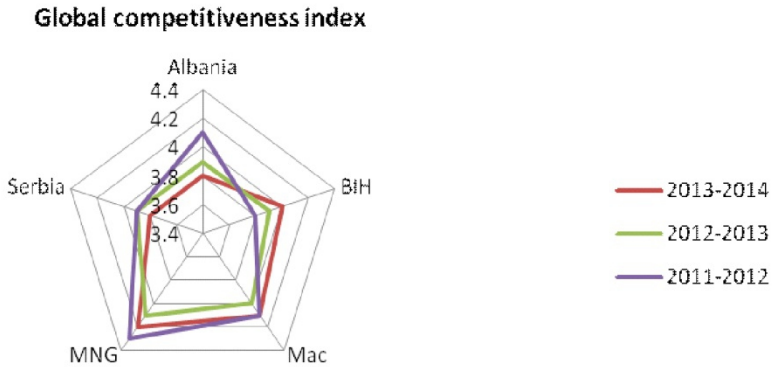

Figure 1 Global Competitiveness report 2011-2015, *Source* World Economic Forum

In the figure 1, we can see that the country being closer to the centre is less competitive than the country being in the edges. The best-ranked economy on the last four years has been Montenegro and the worst ranked

has been Serbia. We can see that Albania and Macedonia have had more variation in the score, and Serbia has had less variation.

The countries of the Western Balkan have a negative trade balance. In the figure 2 is shown the trade balance of the countries of the Western Balkan from 2009 to 2013. As we can see all of the countries have a negative trade balance since 2009. Serbia has the highest trade deficit, followed by Bosnia and Herzegovina, than Macedonia, Albania and last is Montenegro.

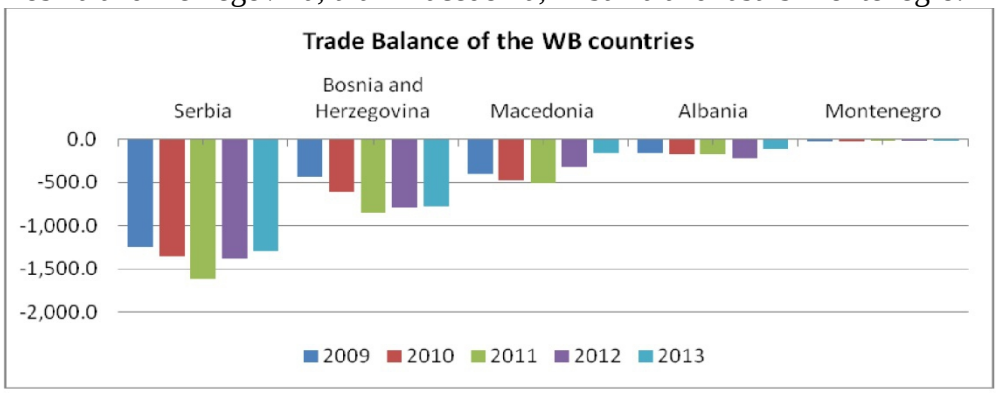

Figure 2 Trade balance, Source Eurostat

Serbia has the highest deficit but on the other side is the biggest economy in the region, and with the smallest trade deficit Montenegro is the smallest economy in the region. Reducing the trade deficit has been in the focus of the governments of the countries of the region, for that instruments for reducing the trade deficit needs to de identify.

Can improving competitiveness improve the balance of trade? In order to answer that question the correlation coefficient between the trade balance and the scores of each of the competitiveness pillars will be calculated.

Table 1 Score for each pillar of competitiveness

		Health and primary education	Efficiency enhancement	goods market efficiency	labor market efficiency	financial market development	technological readiness	market size	Innovation and sophistication factors	business sophistication	innovation	Trade balance
Albania	`13	5.9	3.7	4.1	4.3	3.3	3.3	2.9	3.1	3.4	2.8	-106.3
Albania	`12	5.6	3.8	4.3	4.4	3.4	3.7	2.9	3.1	3.6	2.6	-214.1
Albania	`11	5.7	3.9	4.5	4.6	3.6	3.8	2.9	3.2	3.8	2.6	-169.0
BIH	`13	6	3.8	4	4.2	3.5	3.7	3.1	3.4	3.5	3.3	-772.3
BIH	`12	5.9	3.7	3.9	4.1	3.4	3.8	3.1	3.3	3.5	3.1	-791.2
BIH	`11	5.8	3.6	3.8	4.2	3.3	3.6	3	3.1	3.4	2.8	-845.6
Macedonia	`13	5.6	4	4.5	4.2	4.1	3.8	2.9	3.4	3.6	3.1	-156.8
Macedonia	`12	5.6	4	4.3	4.1	4	3.8	2.8	3.1	3.4	2.8	-314.2
Macedonia	`11	5.5	3.8	4.3	4.3	3.9	3.7	2.8	3.1	3.5	2.8	-509.4
Montenegro	`13	6.1	4	4.3	4.4	4.4	4.2	2.1	3.6	3.8	3.4	-3.5
Montenegro	`12	5.7	4	4.4	4.1	4.5	4.1	2.1	3.6	3.8	3.3	-11.6
Montenegro	`11	5.8	4.1	4.5	4.6	4.6	4	2	3.6	3.8	3.4	-9.9

Serbia	`13	5.7	3.8	3.6	3.9	3.5	3.9	3.7	3	3.2	2.9	-1,289.0
Serbia	`12	5.7	3.8	3.6	4	3.7	4.1	3.6	3	3.1	2.8	-1,381.5
Serbia	`11	5.8	3.7	3.5	3.9	3.7	3.6	3.6	3	3.1	2.9	-1,618.6
Correlation with the trade balance		**0.0015**	**0.6196**	**0.9380**	**0.7541**	**0.4796**	**0.113**	**-0.863**	**0.6459**	**0.8801**	**0.2508**	

The correlation analyses show that there is a weak correlation of the Global Competitiveness Index and the trade balance (0.6057). To find connections between competitiveness and the trade balance we will have a look into all the pillars of competitiveness.

In the table 1 is shown the score of each of the competitiveness pillars with an expected influence on trade as by three competitiveness reports, 2013-2014, 2012-2013, 2011-2012. On the last column is shown the trade balance in million Euros. In the last row is shown the correlation between the trade balance and each of the pillars of competitiveness.

As it is shown on the table the factors which have no correlation with trade balance is health and primary education, technological readiness and innovation.

There is strong correlation between trade balance and goods market efficiency (0.9380). The strong positive correlation, gives us a tool to influence the trade balance, by improving the goods market efficiency. Countries with efficient goods markets are well positioned to produce the right mix of products and services given their particular supply-and-demand conditions, as well as to ensure that these goods can be most effectively traded in the economy. Healthy market competition, both domestic and foreign, is important in driving market efficiency and thus business productivity by ensuring that the most efficient firms, producing goods demanded by the market, are those that thrive World Economic Forum (2014).

The second strongest relation is between trade balance and business sophistication (0.88019), that means that an increase in the business sophistication will be accompanied by an increase in the trade balance, for that more efforts on business sophistications needs to be put in order to have better trade balance. Sophisticated business practices bring higher efficiency in the production of goods and services. Business sophistication concerns two elements that are linked: the quality of a country's overall business networks and the quality of individual firms' operations and strategies. By improving the business sophistication the companied of one country become more competitive also in international markets, for that the opportunity to export is higher, by resulting a better trade balance.

There is a negative relation between market size and trade balance, the smaller the market size better is the trade balance. This is a factor we

cannot influence and we don't recommend to be used for influencing the trade balance.

Two factors with weaker influence on trade balance are efficiency enhancement (Correlation 0.6196), and innovation and sophistication factors (0.6459).

As the competitiveness factor with the strongest correlation with trade balance is the goods market efficiency, we will examine which of the components of this factor has the strongest correlation to the trade balance.

In the figure 3, are shown in a spider graphics the correlation coefficients between the trade balance and each of the indicators of goods market efficiency. We can see that the majority of the indicators of goods market efficiency have a correlation with the trade balance (values from 0.5-1).

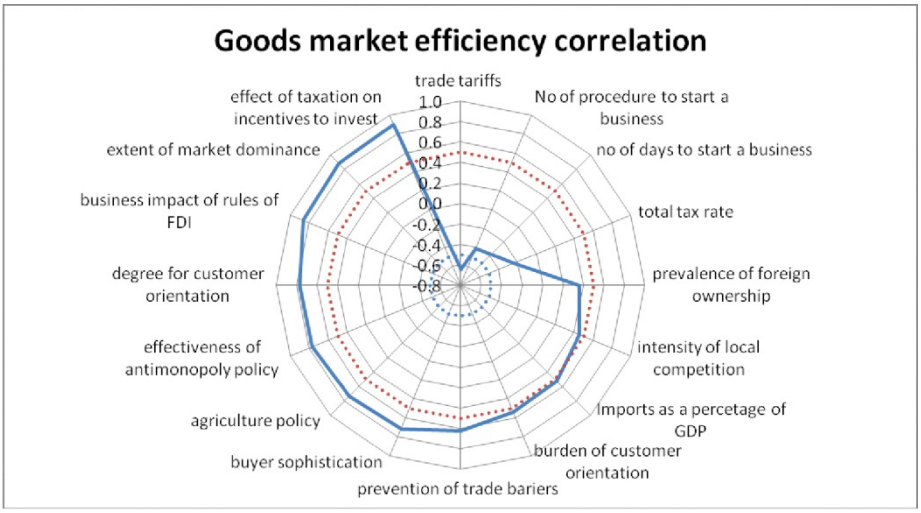

Figure 3 correlation coefficient

All the values falling between the two interrupted lines are in the interval $[0.5, -0.5]$ and for that, there is no correlation of those indicators with the trade balance. As it is shown in the figure 2 most of correlation coefficients of the indicators for goods market efficiency has a value higher than 0.5 showing some correlation between the indicator and the trade balance. There are four indicators with a high correlation with the trade balance. The strongest correlation is between the trade balance and effect of taxation on incentives to invest (0.90398). That means that an improve of the taxation as an incentive to invest will improve the trade balance.

The second strongest correlation is between the trade balance and the extend of market dominance (0.87985), the third strong correlation is with the business impact of rules of Foreign Direct Investments.

Based on the correlation coefficients the balance of trade can be influenced by creating a better business environment by attractive taxation system, better rules for FDI and better Market dominance.

Conclusion

The countries of the Western Balkan have a moderated competitiveness, which makes them not so attractive to foreign investments.

The countries of the Western Balkan have negative balances of trade. The bigger the size of the economy, the higher is the trade deficit. There is a weak correlation between the trade balance and the competitiveness index.

In order to improve the trade balance governments can use instruments for improving competition. Some of the instruments for influencing the balance of trade are improving the goods market efficiency, improving business sophistication, and better climate for Foreign Direct Investments. A taxation system as an incentive to invest will improve the trade balance and also functioning competition market economy.

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